

TITLE 10. CALIFORNIA DEPARTMENT OF CORPORATIONS

NOTICE IS HEREBY GIVEN

The Commissioner of Corporations (Commissioner) proposes to amend regulations under the Corporate Securities Law of 1968 (CSL, Corporations Code Section 25000 et seq.) relating to exemption for certain investment advisers pursuant to Corporations Code Section 25230. The Commissioner proposes to amend Section 260.204.9 of the California Code of Regulations (10 C.C.R. § 260.204.9).

PUBLIC COMMENTS

No public hearing is scheduled. Any interested person or his or her duly authorized representative may request, in writing, a public hearing pursuant to Section 11346.8(a) of the Government Code. The request for hearing must be received by the Department of Corporations' (Department) contact person designated below no later than 15 days prior to the close of the written comment period.

WRITTEN COMMENT PERIOD

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory action to the Department, addressed to Karen Fong, Office of Legislation and Policy, Department of Corporations, 1515 K Street, Suite 200, Sacramento, California 95814-4052, no later than 5:00 p.m., November 26, 2007. Written comments may also be sent to Karen Fong via electronic mail at regulations@corp.ca.gov or via fax at (916) 322-5875. If this day is a Saturday, Sunday or state holiday, the comment period will close at 5 p.m. on the next business day.

INFORMATIVE DIGEST/PLAIN ENGLISH OVERVIEW

Under current law, the Department regulates certain activities of investment advisers in California. Specifically, Section 25230 of the CSL requires persons conducting business as an investment adviser in California to be licensed with the Department. Investment advisers licensed under the CSL are subject to various obligations and restrictions, as set forth in the CSL and the rules of the Commissioner.

Section 25204 of the CSL provides the Commissioner with authority to exempt any person from the licensing requirement of Section 25230 of the CSL, as necessary or appropriate in the public interest or for the protection of investors. In 2002, the Commissioner adopted Rule 260.204.9, which exempts from licensing certain investment advisers with fewer than 15 clients and more than \$25 million in assets under management, or that provide advice only to venture capital companies, as defined in the rule.

In particular, the rule exempts from licensing as an investment adviser any person who:

1. Does not hold itself out generally to the public as an investment adviser;
2. Has fewer than 15 clients;
3. Is exempt from registration under the federal Investment Advisers Act of 1940 (Advisers Act) by virtue of Section 203(b)(3) of that act; and

4. Either (i) has "assets under management" of not less than \$25 million or (ii) provides investment advice to only "venture capital companies," as defined in the exemption.

Various factors have caused the Commissioner to reexamine the basis for the exemption from registration under Rule 260.204.9 beyond advisers to venture capital companies. See Section 25204 of the CSL. Those factors include the concerns with the lack of regulatory oversight of advisers to hedge funds, as set forth in the Securities and Exchange Commission's 2003 report, *Implications of the Growth of Hedge Funds*. In addition, based on changed market conditions, the current rule appears to create an unwarranted disparity in treatment of investment advisers that no longer serves any meaningful public benefit.

In response to the growth of hedge funds, the increase in fraud related to hedge fund activities, and the broadening market participants in hedge funds, amendments to Rule 260.204.9 are proposed to remove the exemption for advisers that are not advisers to venture capital companies, as defined in the rule.

AUTHORITY

Sections 25204 and 25610, Corporations Code.

REFERENCE

Section 25230. Corporations Code.

AVAILABILITY OF MODIFIED TEXT

The text of any modified regulation, unless the modification is only non-substantial or solely grammatical in nature, will be made available to the public at least 15 days prior to the date the Department adopts the regulation(s). A request for a copy of any modified regulation(s) should be addressed to the contact person designated below. The Commissioner will accept written comments on the modified regulation(s) for 15 days after the date on which they are made available. The Commissioner may thereafter adopt, amend or repeal the foregoing proposal substantially as set forth above without further notice.

AVAILABILITY OF STATEMENT OF REASONS, TEXT OF PROPOSED REGULATIONS/INTERNET ACCESS

The express terms of the proposed action may be obtained upon request from any office of the Department. Request Document PRO 41/06-B. An initial statement of reasons for the proposed action containing all the information upon which the proposal is based is available from the contact person designated below. Request Document PRO 41/06-C. These documents are also available at the Department's website www.corp.ca.gov. As required by the Administrative Procedure Act, the Office of Legislation and Policy maintains the rulemaking file. The rulemaking file is available for public inspection at the Department of Corporations, Office of Legislation and Policy, 1515 K Street, Suite 200, Sacramento, California 95814-4052.

AVAILABILITY OF THE FINAL STATEMENT OF REASONS

Upon its completion, the Final Statement of Reasons will be available and copies may be requested from the contact person named in this notice or may be accessed on the website listed above.

CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Department must determine that no reasonable alternative it considered or that has otherwise been identified and brought to the attention of the Department would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed action.

FISCAL IMPACT

- Cost or savings to any state agency: None.
- Direct or indirect costs or savings in federal funding to the state: None.
- Cost to local agencies and school districts required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code: None
- Other nondiscretionary costs/savings imposed on local agencies: None
- Costs to private persons or businesses directly affected: Insignificant or none.

DETERMINATIONS

The Commissioner has made an initial determination that the proposed regulatory action:

- Does not affect small businesses. Investment advisers are not small businesses under Government Code Section 11342.610(b)(1).
- Does not impose a mandate on local agencies or school districts, or a mandate that is required to be reimbursed pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.
- Does not have an effect on housing costs.
- Does not have a significant statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states.
- Does not significantly affect the creation or elimination of jobs within the State of California; the creation of new businesses or the elimination of existing businesses within the State of California; or the expansion of businesses currently doing business within the State of California.

COST IMPACTS ON REPRESENTATIVE PRIVATE PERSON OR BUSINESS

An adviser not currently subject to licensure that becomes subject to licensure as a result of the changes to the exemption proposed in this rulemaking action may incur costs from the following activities: preparing the Form ADV and obtaining licensure through the Department; reporting investment adviser representatives to the Department; preparing the disclosures required under Part II of Form ADV and complying with other disclosure requirements; complying with the books and records, custody, ethics, minimum net worth, and reporting requirements, as applicable; and undergoing routine regulatory examinations.

EFFECT ON SMALL BUSINESS

It has been determined that the amendment of this regulation will not affect small business. Under Government Code Section 11342.610(b)(1), investment advisers are not a small business.

CONTACT PERSON

Nonsubstantive inquiries concerning this action, such as requests for copies of the proposed regulation or questions regarding the timelines or rulemaking status, may be directed to Karen Fong at (916) 322-3553. The backup contact person is Marilyn Kaspar at (916) 322-3553. Inquiries regarding the substance of the proposed regulation may be directed to Michael Santiago, Corporations Counsel, Department of Corporations, 1515 K Street, Suite 200, Sacramento, California 95814, (916) 322-3553.

Dated: September 14, 2007
Sacramento, California

Timothy L. Le Bas
Deputy Commissioner
Office of Legislation and Policy